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The Deal

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Deal Flow *in an* Ever-Expanding M&A Landscape

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SPECIAL REPORT

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Navigating today's competitive deal landscape many present many more challenges to buyers than in years past.

Buyers are struggling to find quality, affordable targets given that sellers' rising expectations are leading to exponential multiple expansion.

But as private equity coffers continue to grow exponentially with record levels of dry powder, rapid capital deployment remains imperative.

For private equity firms to succeed in this world of high-profile take-private deals and leveraged buyouts, they must be willing to do more than pay a hefty sum for targets, according to Pepper Hamilton LLP partner James Rosener who is managing partner of the firm's New York office and devotes his legal practice to international transactions, private equity, mergers and acquisitions deals.

"While price matters, it tends to be less of an issue than the will to win the deal," Rosener said at a recent conference hosted by The Deal. "Clients are applying several millions of dollars to due diligence and negotiation effort to distinguish themselves from other bidders. Thus, they want to be sure they have a reasonable chance of winning the deal."

One person who can attest to that is Christopher Smith, a vice president of private equity firm GTCR LLC, which targets investments in the healthcare, technology and financial services sectors.

"For everyone in the firm, a lot of our time is spent in those industries working with executives, management teams, investment bankers, lawyers and various other intermediaries to really know those sectors backwards and forwards," he said during the panel. "And we do that so that when you have to pay those high prices, as you do in this market if you want to put capital to work, you can really develop a lot of conviction. You can make certain not only that you win whatever the process is, but you have the conviction to pay what are pretty high multiples for good quality assets."

Because for sellers, the best bid isn't always the one with the highest price tag. As founder-run Silicon Valley startups have shown time and time again, there are several things to consider beyond valuation when it comes to selling your company.

"In the case of entrepreneurial owners, where a guy has built a business, he might feel it's a little more important to make sure that his employees are well taken care of, make sure the strategy is consistent with his," Pepper Hamilton's Rosener said. "He might stay on and roll some of his interests over, so I think it's still price, but not as much as the overall package."

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>
> *James Rosener, Partner, Pepper Hamilton*

But economics still matter in the technology sector, where multiples have crept toward astronomical levels in recent years, and firms have to cut through the noise that leads to lofty values and change the way they view platform companies as a result, according to Insight Partners managing director Ryan Hinkle.

"We aren't buying today's value; we're buying five years from now at a predicted range of predicted value change," Hinkle said on the panel. "We always price it as, 'What's the unit of risk I'm inheriting, and what return do I get for that?' So the more specific you get, the more you can understand what it takes for success and the easier it is to articulate that."

Because as recently as 10 years ago, as a private equity buyer, there were items you would factor in when you're considering a deal, such as cost reductions, that you believed would get you to where you needed to be to achieve the value you're seeking from a platform company. This made you more willing to be pay elevated multiples on Ebitda, Hinkle explained, but today, you're being forced to plan ahead much further for factors such as additional bolt-on deals.

"For buyers, in some ways, we have to operate with this ballerina-like precision on not just the operations of the business and thinking about the profit profile of the future, but also this contingent of M&A where if you're not doing M&A, in some cases it's going to break the thesis entirely," he said. "You have to embed that into your earning case, which is a pronounced difference from say 10 years ago."

Another developing trend in today's market across industries, including healthcare and technology, is the increasing tendency for corporations to make large-scale M&A that includes several businesses or assets that the buyer has no interest in acquiring.

In December 2015, Dow Chemical Co. and DuPont announced a $130 billion merger that would take more than 18 months to complete and would result in the combined company splitting into three publicly traded entities, each divesting a number of pieces along the way.

This year, United Technologies Corp. (UTX) announced an $86 billion acquisition of competitor Raytheon Co. (RTN) – one of 20 deals worth more than $10 billion announced in 2019 – and the buyer expects to separate into three companies upon completion, all of which could be sources of future carveouts.

An increase in deals like this creates a an ever-expanding group of sponsors with an appetite for carveouts, but these buyers have to be nimble and well-educated in the complexities of these types of transactions, Pepper Hamilton's Rosener explained.

"Carveouts are getting much more active," Rosener said. "And there are people who look at large acquisitions, and if you're careful and thinking about what businesses fit and what businesses don't fit, and you're good at carveouts, it's a good opportunity at price levels that are really not auction multiples. They're proprietary and negotiable." ■